

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
UNITED CALIFORNIA BANK, }  
SUCCESSOR IN INTEREST TO FIRST }  
WESTERN BANK AND TRUST COMPANY }

Appearances:

For Appellant: George H. Koster, Attorney at Law  
For Respondent: A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 2566'7 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of United California Bank, Successor in Interest to First Western Bank and Trust Company, against proposed assessments of additional franchise taxes in the amounts of \$53,610.87 and \$2,190.31 for the taxable years 1956 and 1958, respectively.

In 1954, First Western Bank and Trust Company purchased the assets and businesses of 23 banks which were subsidiaries of Transamerica Corporation. Transamerica owns 76 percent of First Western 'S stock. For convenience, First Western will be referred to hereafter as appellant.

in the course of the negotiations for the purchase, it was agreed that the employees of the sellers were to become employees of appellant and that appellant would adopt a pension plan for the employees similar to the plan then in existence. Before the negotiations were completed, it was determined that the sellers had not paid sufficient premiums to the insurance company that administered the existing plan to completely fund the cost of retirement benefits based upon services of the employees prior to the adoption of the plan. The sum required to fully fund these past service credits was \$196,912.16. Before the purchase was made, this amount was deducted from the previously agreed upon price attributable to goodwill of the businesses. There is nothing in the record to indicate

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that the sellers were at any time legally obligated to pay this amount.

When appellant completed the purchase, it made an arrangement with Transamerica and the insurance company which administered the existing pension plan whereby the plan was amended to name appellant as "successor employer." The existing credits to the employees were retained and the plan continued to provide for the same benefits to them. In addition to the amounts required to maintain the plan on a current basis, appellant proceeded to pay \$19,691.21 each year to fund the past service credits. It was contemplated that the past service payments would be made over a 10 year period.

Relying upon section 24601 of the Revenue and Taxation Code, appellant claims that the annual payments toward funding the past service credits are deductible. Respondent's position is that these payments constitute part of the purchase price of the banking businesses and as such are not deductible. Certain other adjustments entering into the proposed assessments have **not** been protested by appellant.

Section 24601, like the federal statute from which it was adopted, allows an annual deduction of the normal cost of a pension plan for employees, plus 10 percent of the total amount required to fund or purchase past service credits. The United States Internal Revenue Service has ruled that payments to fund past service credits are not to be considered as compensation to employees for past services but, instead, as compensation for current employment. (Rev. Rul. 62-139, 1962-2 cum. Bull. 123.)

One of the requirements of the section involved is that the payments satisfy the conditions of section 24343 of the Revenue and Taxation Code. The pertinent conditions are that the payments must constitute "ordinary and necessary" business expenses and "reasonable compensation." (See Rev. Rul. 62-139, supra.) The question of reasonable compensation need not detain us in view of the fact that the annual payments of less than \$20,000 were allocable among all of the employees of what were formerly 23 banking businesses. And, aside from the connection of these payments with the purchase of the businesses, there can be no serious question whether the payments were ordinary and necessary in the course of appellant's operations.

As implicitly recognized in the above cited ruling by the Internal Revenue Service, the allowance under a pension plan of credit for services rendered to a former employer is not in itself extraordinary or unnecessary. Since appellant was merely continuing the same businesses, it was particularly appropriate to continue essentially the same pension plan for

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the employees, giving credit for past services in order to prevent disruption and maintain employee morale, According to the cited ruling, these payments may properly be regarded as compensation for current services by the employees. **As** such, they would appear to be as ordinary and necessary as direct wages for current **services**.

Respondent attempts to draw an analogy between the purchase of the banking businesses with the intent of funding past service credits and the purchase of property with the Intent of demolishing a **building** existing thereon\* Citing Mertens, Law of Federal Income Taxation, §§ 21.17, 23.25 and 28.23, respondent states that the **rule** is that the cost of **demolishing** the building **is** not a deductible expense but must be **capitalized** as part of the cost of the land.

The tax accounting considerations attending the demolitfon of a building **are, however**, unusual and, as **indicated** in the above citations, the development of the rules pertaining thereto has been long and **controversial**. The situation is sufficiently unique as to be covered in particularity by state and federal regulations, Cal, Admin. Code', tit. 18, reg. 24121d(2); Treas. Reg. 1.165-3.) Because of the peculiar nature of the tax problems presented by the demolition of a building, we do not regard the rules developed in that area as controlling; **over** the matter at hand,

**In view of the fact** that the payments in question may properly **be** considered as compensation for **services** rendered to appellant after the purchase of the banking businesses, and in view of the specific statutory authority for **deducting** them, **we** do not believe that **they** were made **nondeductible** through their **relationship** to the **purchase**.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section **25667** of the Revenue and Taxation Code, that the action of the Franchise Tax Board **on the** protest of United California Bank, Successor in Interest to First Western Bank and Trust Company, against proposed assessments of additional franchise taxes **in** the amounts of **\$53,610.87** and **\$2,190.31** for the taxable years **1956** and **1958**, respectively, be reversed Insofar as the action relates to the payments to fund past service **credits** under the pension plan described **in the opinion on file.**

Done at . Sacramento California, this 12th day  
of May 1964, by the Stake Board of Equalization,

<u>Paul R. Leake</u>	Chairman
<u>John W. Lynch</u>	Member
<u>Michael D. Harris</u>	Member
<u>Scott Sperry</u>	Member
_____	Member

Attest:

W. Freeman

Secretary